

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Elimination of Rate-of-Return Regulation	)	RM-10822
of Incumbent Local Exchange Carriers	)	
	)	
Federal-State Joint Board on Universal	)	CC Docket No. 96-45
Service	)	
	)	

**WESTERN WIRELESS REPLY COMMENTS**

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Transformed the Universal Service Fund for Consumers into  
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by Economics and Technology, Inc.

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**WESTERN WIRELESS REPLY COMMENTS**

Western Wireless Corporation (“Western Wireless”), by counsel, hereby replies to comments on its Petition for Rulemaking to eliminate rate-of-return (“ROR”) regulation of rural incumbent local exchange carriers (“rural ILECs” or “RLECs”). The Commission should open a rulemaking proceeding to eliminate ROR-based access charges as part of inter-carrier compensation reform, and should refer the issue to the Federal-State Joint Board on Universal Service for a recommendation on replacing the ROR-based universal service support mechanisms with a competitively-neutral, forward-looking, least cost technology-based universal service funding mechanism for all carriers.

**INTRODUCTION AND SUMMARY**

The time has come to begin dismantling the antiquated and inefficient system of ROR regulation and developing its replacement. As Western Wireless showed in its Petition for Rulemaking, ROR regulation is antithetical to the

emergence of competition. The Petition also demonstrated – and the comprehensive economic analysis in the report attached to these Reply Comments confirms – that the ROR regulatory system unnecessarily bloats the universal service fund, creates incentives for ILEC inefficiency, and opens substantial opportunities for waste, fraud, and abuse. These conclusions are buttressed by the cogent comments submitted by the Ad Hoc Telecommunications Users Committee, Centennial, GCI, MCI, Nextel, and T-Mobile.

In contrast to the hard data and economic analysis offered by Western Wireless, the rural ILECs' representatives offer nothing but puffery in support of the archaic system of ROR regulation. To be sure, they freely criticize Western Wireless' arguments, and dish up an assortment of fierce, but irrelevant, *ad hominem* attacks on Western Wireless. But not one of them provides any economic analysis demonstrating that ROR regulation is an efficient or effective system for determining high-cost universal service support or inter-carrier compensation in the 21st century. Nor could they. As shown in the Petition, Congress, the courts, and the FCC all have emphatically rejected embedded cost-based ROR regulation – at least in theory. The time has come to begin putting this correct theoretical consensus into practice, by developing a forward-looking and competitively-neutral system for rural ILECs, just as it has done for larger ILECs.

At root, ROR regulation – a system of revenue guarantees for rural ILECs – is nothing but an unjustified form of “corporate welfare.” The time has arrived to end this unjustified gravy train, and develop a new universal service

policy focused – as the 1996 Act requires – on “sufficient funding of *customers*, not *providers*.” <sup>1/</sup> The rural ILECs themselves need to adopt the worldview that the U.S. Telecom Association recently urged upon AT&T:

“In asking the government to avoid picking winners and losers, Mr. Dorman seems to recognize the need for AT&T to move beyond reliance on corporate welfare and government-managed competition into today's world of real competition among wireline, wireless, cable, satellite and powerline platforms.” <sup>2/</sup>

By the same token, it is time for the rural ILECs to stop asking the government to pick *them* as winners and wireless carriers as losers, move beyond reliance on the ROR form of corporate welfare and government-managed competition, and enter today's world of real competition.

#### **I. ROR REGULATION CREATES INCENTIVES FOR INEFFICIENCY, BLOATS THE UNIVERSAL SERVICE FUND, AND IS HIGHLY SUSCEPTIBLE TO FRAUD, WASTE, AND ABUSE**

The attached report, “*Lost in Translation: How Rate of Return Regulation Transformed the Universal Service Fund for Consumers into Corporate Welfare for RLECs*,” authored by Economics and Technology, Inc., analyzes cost data from NECA’s 2003 USF submission encompassing 90% of the loops served by rural ILECs, plus additional data for a sample of 140 rural ILECs. The report confirms that ROR regulation gives rural ILECs powerful incentives and

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<sup>1/</sup> *Alenco Communications v. FCC*, 201 F.3d 608, 620 (5th Cir. 2000) (emphasis in original).

<sup>2/</sup> Statement of U.S. Telecom Association president Walter McCormick, quoted in H. Buskirk, “AT&T’s Dorman Ties VOIP to UNE-P; Calls for Regulatory Certainty,” *Telecommunications Reports Daily*, Feb. 11, 2004, and in S. Polyakova, “Creation of Regulatory Distinctions in VoIP Said to Concern AT&T,” *Communications Daily*, Feb. 12, 2004.

opportunities to operate inefficiently. For example, the report demonstrates the following:

- ***Excessive Funding.*** The largest single causes of federal high-cost universal service fund growth are the over \$500 million increase in the size of the ROR-driven LTS, LSS, and ICLS funds since each of those funds was transferred from access charges to explicit universal service funds, <sup>3/</sup> and the over \$200 million annual increase in the size of the ROR-driven High Cost Loop fund since 1999. <sup>4/</sup> These amounts are substantially greater than funding to competitive eligible telecommunications carriers (“CETCs”), which still amounts to only about 6.1% of the total high-cost fund. <sup>5/</sup>
  - The report demonstrates that this rate increase is highly anomalous, given that costs have been declining throughout the telecommunications sector.
- ***ROR Encourages Dis-economies of Scale.*** Rural ILECs have systematically foregone opportunities to obtain increased economies of scale – a key driver of efficiencies and cost savings in the telecommunications sector – through mergers and/or consolidation of study areas. Instead, the rural ILECs are generally opting to remain small, since they receive larger amounts of support as a consequence.

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<sup>3/</sup> See Appendix A at 7-8. Some RLEC groups contend that, even if problems exist with cost studies, in light of the small size of the rural ILECs, the “overall differences in interstate or intrastate rates are likely to be miniscule.” NECA/NTCA/OPASTCO/et al. at 9. Hundreds of millions of dollars per year are anything but miniscule. And the problems are not isolated to individual instances, but pervasive and symptomatic of a system that no longer functions effectively.

<sup>4/</sup> Compare USAC Quarterly Administrative Filing, 1st quarter 1999, with USAC Quarterly Administrative Filing, 2nd quarter 2004 (available at <http://www.universalservice.org/overview/filings/>).

<sup>5/</sup> Contra RICA at 9-10; SDTA at 10.

- The report analyzes financial data regarding transactions in the small ILEC sector, and shows that they are heavily driven by artificial considerations relating to ROR-driven universal service support and access charges.
- **Excessive Overhead Expenditures.** Many rural ILECs appear to be incurring excessively high Corporate Operations Expenses and are operating with management employees far in excess of the number employed by comparably sized companies. Instead of being penalized for incurring excessive overheads and other costs by the discipline of the marketplace, the rural ILECs are rewarded for their inefficiency through universal service funding guaranteed by the ROR system.
  - By benchmarking the performance of rural ILECs in 874 study areas against their peers (the top 25% “best-in-class”), the report finds that about one-third of the rural ILECs’ total claimed Corporate Operations Expenses are attributable to inefficiency. These identified inefficiencies amount to some \$545-million annually.
  - The report includes an analysis of management headcount and reported Corporate Operations Expenses, and shows that a significant number of rural ILECs are incurring overhead costs far in excess of those incurred by more efficient carriers of similar size – and are reaping large universal service payments as a result.
  - Excessive levels of overhead costs also suggest inefficiencies in other areas of an ILEC’s operations. For example, the attached analysis shows that the Texas rural ILECs with the highest Corporate Operations Expenses also report substantially higher Total Plant In Service per access line than other ILECs. These same carriers are among the largest recipients of federal universal service money in the state.
- **No Oversight.** Neither the FCC nor state commissions sufficiently examine the books of the vast majority of rural ILECs. Indeed, the FCC receives earnings

reports from only 47 of the more than 1,400 rural ILEC operating companies. In essence, even if ROR made sense in theory, it is not working well in practice, because *no one is minding the store*. As a consequence, a substantial number of companies are earning rates of return far in excess of the authorized level.

- The report includes an analysis of rural ILECs' earnings in excess of the permitted rate of return.

The problems with ROR regulation are not isolated to individual carriers; they pervade the entire system. Thus, the problems unearthed by regulators to date, such as those listed in the appendices to Western Wireless' Petition, show that the system is not functioning effectively. <sup>6/</sup> Indeed, given the lack of oversight over the rural ILECs, these problems merely provide an indication of the magnitude of the proverbial tip of the iceberg, which is almost certainly dwarfed by the problems that have never been and never will be detected.

Moreover, the fact that several of the improprieties identified in the Petition involved large ILECs regulated under price caps or alternative forms of regulation, not ROR, <sup>7/</sup> means that the likelihood of similar or worse problems among ROR ILECs is heightened and demands exploration by the FCC. The rural ILECs, under rate of return regulation, have a much stronger incentive to manipulate their regulatory books in order to overstate their costs and inflate their revenue requirements – and as noted above, few, if any, checks are in place to prevent such misconduct. NECA audits do not provide a credible check – by joining

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<sup>6/</sup> NECA/NTCA/OPASTCO/et al. at 10; Oklahoma RTCs at 9; PRTC at 4; RICA at 8-9; SDTA at 8-9.

<sup>7/</sup> CenturyTel at 12; Oklahoma RTCs at 6; OIU/HTC at 2; PRTC at 4.



with NTCA, OPASTCO, and other advocates in a filing in this proceeding, NECA demonstrates vividly that it is anything but an objective and independent overseer of the rural ILECs. <sup>8/</sup> Rather, it is managed by the rural ILECs, devoted to serving their needs, and utterly lacks the independence needed for a true audit. Moreover, the FCC lacks effective enforcement mechanisms to detect or remedy ILEC over-earnings. <sup>9/</sup>

The fact is that ROR regulation rewards rural ILECs with hefty cash flow regardless of whether or not their expenditures are prudent and appropriately used to advance universal service for consumers. There is no question that many rural ILECs under the ROR system have made extensive investments, and a good number of these investments may benefit consumers. <sup>10/</sup> But this may be serendipitous, since nothing in the ROR system protects against inefficient or wasteful expenditures. Indeed, the ROR system has been found to give carriers an incentive for inefficiency. <sup>11/</sup>

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<sup>8/</sup> See NECA/NTCA/OPASTCO/et al. Comments. See also Oklahoma RTCs at 7; Staurulakis at 7-8 (arguing that NECA effectively ensures the accuracy and reasonableness of ROR RLECs).

<sup>9/</sup> See Petition at 28-29; GCI at 7-8, 10-13; MCI at 1-2.

<sup>10/</sup> NECA/NTCA/OPASTCO/etc. at 10-11; MTA at 4-5; Nebraska RICs at 13; Oklahoma RTCs at 2, 9; PRTC at 3; SDTA at 6-7; RICA at 5-6; Staurulakis at 5; TCA at 5-6; Wiggins at 2-3.

<sup>11/</sup> See Petition at 20-24 and sources cited therein; see also GCI at 6-10; MCI at 2-3; Nextel at 4.

## II. ROR REGULATION ARTIFICIALLY INTERFERES WITH COMPETITION

Western Wireless showed in the Petition for Rulemaking that ROR regulation inhibits competition. By singling out one favored class of carriers – rural ILECs – and targeting their interstate access rates and universal service support to achieve a guaranteed return on investment on all historical costs incurred, the ROR system creates an insurmountable barrier to full competition on a level playing field. By contrast, wireless ETCs receive support only on a per-line basis – with no investment or revenue guarantees – and are barred from recovering federally tariffed interstate access charges. <sup>12/</sup>

The RLECs' objections to this argument can easily be laid to rest. First, it cannot seriously be argued that competition is an irrelevant policy goal when it comes to implementing the 1996 Act's universal service provisions. <sup>13/</sup> The 1996 Act requires the Commission to advance both competition and universal service simultaneously, and the Commission has emphatically rejected the notion that these two goals are irreconcilable or conflicting. <sup>14/</sup> By refocusing the

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<sup>12/</sup> See Petition at 18-21; accord GCI at 8-10.

<sup>13/</sup> *Contra* CenturyTel at 2-3, 18-22; accord GVNW at 3; MTA at 3-4; OIU/HTC at 4-5.

<sup>14/</sup> “Commenters who express concern about the principle of competitive neutrality contend that Congress recognized that, in certain rural areas, competition may not always serve the public interest and that promoting competition in these areas must be considered, if at all, secondary to the advancement of universal service. We believe these commenters present a false choice between competition and universal service. A principal purpose of section 254 is to create mechanisms that will sustain universal service as competition emerges. We expect that applying the policy of competitive neutrality will promote emerging technologies that, over time, may provide competitive alternatives in rural, insular, and high cost areas and thereby benefit rural consumers.” *Federal-State Joint Board on Universal Service*, First Report and Order, 12 FCC Rcd 8776, 8802-03, ¶ 50 (1997), *subsequent history omitted* (emphasis added, footnotes omitted).

universal service support system to assure “sufficient funding of *customers*, not *providers*,” the Commission can advance both goals.

Second, the fact that Western Wireless and other competitive carriers are managing to compete, despite these obstacles, does not mean that the obstacles do not exist. <sup>15/</sup> To the contrary, the Commission has conclusively determined that unlawful barriers to entry include not only restrictions that completely preclude an entity from competing, “but also restrictions that indirectly produce that result.” <sup>16/</sup> In this regard, it should be emphasized that Western Wireless has never taken the position that universal service support should be used to artificially generate competition in areas where competition is uneconomic. <sup>17/</sup> Rather, the Commission must “balance the promotion of competition with universal service principles,” <sup>18/</sup> and must ensure that universal service is supported in a way that neither

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<sup>15/</sup> CenturyTel at 4-5; SDTA at 6; TCA at 3-5. Nor does Western Wireless contend that ROR presents an absolute revenue guarantee that completely shields the rural ILECs from competitive losses. *Contra* CenturyTel at 5; Staurulakis at 6. However, the increased funding that would be available to rural ILECs pursuant to ROR regulation – and the fact that rural ILECs receive the majority of their revenues not from their own customers, but from universal service funds and carrier access charges (*accord*, Nebraska RICs at 11; OIU/HTC at 4) – substantially mitigate the impacts of competitive losses on rural ILECs. *See also Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission’s Rules Relating to High-Cost Universal Service Support and the ETC Designation Process*, Public Notice, 18 FCC Rcd 1941, 1951-52, ¶ 24 (Jt. Board 2003) (ROR ILECs receive the same amount of universal service support even when they lose lines to CETCs).

<sup>16/</sup> *See Public Utility Commission of Texas Petition for Preemption*, 13 FCC Rcd 3460, 3480, ¶ 41 (1997); *see also Federal-State Joint Board on Universal Service; Western Wireless Corp. Petition for Preemption of an Order of the South Dakota Public Utilities Commission*, Declaratory Ruling, 15 FCC Rcd 15168 (2000).

<sup>17/</sup> Cf. OPASTCO White Paper, *Universal Service in Rural America: A Congressional Mandate at Risk*, p.23 (Jan. 2003) (“It is foolhardy to support multiple carriers merely for the sake of artificially creating competition in areas where there is not a natural market that can sustain even one telecommunications carrier without support.”).

artificially generates nor artificially inhibits competition. <sup>19/</sup> To achieve the goal of eliminating artificial barriers to competition, the discriminatory ROR system must be eliminated, and support must be disbursed in a manner that is truly competitively neutral. <sup>20/</sup>

Finally, some parties argue that competitive ETCs like Western Wireless have unfair advantages over ILECs because they are not subject to onerous regulatory obligations relating to “carrier of last resort” status, and that the petition is an elaborate ruse designed to strengthen those competitive advantages. <sup>21/</sup> These carriers fail to recognize that identical federal “carrier of last resort” obligations apply to incumbent and competitive ETCs pursuant to Section 214(e) of the Act, and that other ILEC regulatory obligations are designed to counter their market power stemming from their historic monopoly status. It would make no sense to impose such requirements on wireless carriers and other new

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<sup>18/</sup> Nebraska RICs at 6.

<sup>19/</sup> “The two fundamental pillars of the Act are universal service and competition. Federal support is intended to promote universal service, not to subsidize artificial competition – *nor, for that matter, to keep it at bay*. Neither of these pillars should be promoted at the expense of the other.” *Rural America and the Promise of Tomorrow*, Remarks of FCC Commissioner Jonathan S. Adelstein at NTCA, Feb. 3, 2003 (as prepared for delivery, p. 3).

<sup>20/</sup> *Accord*, Centennial at 2; GCI at 8-10, 15-16.

<sup>21/</sup> *See, e.g.*, Oklahoma RTCs at 3; OIU/HTC at 6; SDTA at 6; Staurulakis at 6; TCA at 2-3; Wiggins at 2. CenturyTel goes further and argues that wireless carriers offer “inferior” service. CenturyTel at 9, 13-14. Consumers evidently don’t share CenturyTel’s evaluation, as shown by the rates that they are willing to pay for wireless service in an unregulated marketplace. In any event, as long as carriers meet the basic ETC standards, it should be consumers – not regulators – who are empowered to decide which services (or which combinations of services) are “inferior” or “superior” or best meet consumers’ needs. *See supra* text accompanying note 2.

competitive entrants. 22/ However, Western Wireless agrees with those rural ILECs that argue that ILECs should be relieved of certain regulatory obligations if ROR revenue guarantees are eliminated. 23/ As ILECs face increasing competition from wireless carriers and others, they eventually should be relieved of monopoly-era regulations.

### **III. NOW IS THE TIME TO DEVELOP A FORWARD-LOOKING, COMPETITIVELY NEUTRAL HIGH-COST SUPPORT SYSTEM FOR RURAL AREAS**

Western Wireless' Petition is timely. If the Commission issues a Notice of Proposed Rulemaking regarding the elimination of rate-of-return regulation within the next few months, the proceeding can be completed in time to implement a new regulatory system upon the expiration of the RTF and MAG plans in mid-2006. We thus disagree with the rural ILECs who suggest that the Petition was filed too soon, 24/ too late, 25/ or otherwise improperly. 26/ In addition, this

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22/ Cf. *Federal-State Joint Board on Universal Service*, Recommended Decision, 17 FCC Rcd 14095, 14133, 14135 (Jt. Board 2001), Separate Statement of Commissioner Kathleen Q. Abernathy ("[E]qual access was established [for ILECs] as an antitrust remedy – not as a universal service policy. \* \* \* Indeed, as the Commission is considering whether equal access obligations continue to be necessary even for *LECs*, \* \* \* I am frankly puzzled by the argument that we need to adopt an intrusive and backward-looking regulatory requirement for CMRS carriers.").

23/ Columbus at 2-3; Etex at 2-3; South Central at 2-3

24/ GVNW at 2; NECA/NTCA/OPASTCO et al. at 4; PRTC at 9 (arguing that the issues raised in the Petition are scheduled to be addressed in the forthcoming proceeding on rural/non-rural universal service reconciliation). Western Wireless would strongly support consolidating a rulemaking on the ROR issues raised in the Petition with the rural/non-rural universal service reconciliation proceeding.

25/ GVNW at 2, 6 (suggesting, incorrectly, that the Rural Task Force proceeding anticipated and addressed the issues raised here). In fact, the RTF Order specifically noted that the Commission eventually would need "to consider all options, including the use of forward-looking

Petition is absolutely necessary because, while a number of related proceedings are open, none of them specifically proposes ending ROR regulation for both universal service support and access charge purposes. <sup>27/</sup> Western Wireless' initiative supplies the missing link necessary to fill this void. In particular, this petition is consistent with and complementary to the *Portability* proceeding, <sup>28/</sup> because the rules governing universal service support for competitive ETCs cannot be addressed in isolation from the rules governing support for ILECs.

Some commenters misleadingly cite the Rural Task Force's conclusion that it was not possible to develop an appropriate model for use in rural ILEC

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costs, to determine appropriate support levels for both rural and non-rural carriers." *Federal-State Joint Board on Universal Service*, Fourteenth Report and Order, 16 FCC Rcd 11244, 11310, ¶ 170 (2001) ("*RTF Order*"). Note that Western Wireless proposes no change to the existing rural ILEC support mechanisms until the end of the five-year stability period established in the *RTF Order*. See Petition at 42.

<sup>26/</sup> Beacon at 5-6 (arguing that Western Wireless lacks standing because it has not explained how its interests will be affected); see also NECA/NTCA/OPASTCO et al. at 7. "Standing" in the Constitutional sense is not required for filing rulemaking petitions; and in any case Western Wireless has made it abundantly clear how its interests are affected by the current anti-competitive funding system, and how its interests would be affected by the policy changes it seeks (including substantial changes to the computation of universal service funding Western Wireless would receive in the future as an ETC).

<sup>27/</sup> See Petition at 6-7; see also NECA/NTCA/OPASTCO/et al. at 4-5; Beacon at 6;GVNW at 3; MTA at 2-3; Nebraska RICs at 4; PRTC at 8-9; SDTA at 3-4; Staurulakis at 2-4; TCA at 2-3, 7; Valor at 2-3. Beacon argues that the Petition does not clearly identify whether Western Wireless would have the Commission eliminate ROR only for universal service support and access charge purposes, or for all purposes, including for computing confiscation as a constitutional matter. Beacon at 1-4. To clarify, Western Wireless seeks elimination of ROR regulation for all purposes subject to the FCC's jurisdiction. Western Wireless does not believe that ROR is the proper standard for measuring "confiscation" claims as a constitutional matter; but in any case that issue may not be within the purview of the FCC's jurisdiction.

<sup>28/</sup> *Contra*, NECA/NTCA/OPASTCO/et al. at 7-8; SDTA at 4; TCA at 2 (arguing that petition is a diversionary tactic to distract attention from other issues raised in the *Portability* proceeding).

areas – and ignore the Commission’s rejection of that conclusion. <sup>29/</sup> In response to those who contend that Western Wireless should have proposed a workable solution to all problems with cost modeling in rural ILEC areas, <sup>30/</sup> there is no requirement – nor is it reasonable to expect – that a party proposing a new rulemaking proceeding must supply the answers to every question that is likely to come up in that proceeding.

Finally, a few commenters put forward alternative directions for regulatory change. For example, CenturyTel argues for incremental revisions to the ROR rules to give the rural ILECs an option of additional pricing flexibility. <sup>31/</sup> Although Western Wireless disagrees with this specific proposal, Western Wireless would generally agree that, with the elimination of rate of return regulation, the ILECs should be given pricing flexibility in areas where there is competition.

GCI, which generally supports Western Wireless’ Petition, offers one clarification to the transition plan proposed in the Petition. Specifically, GCI argues that, rather than implementing the plan sooner for competitive ETCs than for certain small rural ILECs, the transition to a forward-looking system “should occur at the same time for all carriers (both ILECs and competitive ETCs in a market). In other words, all carriers should transition to the new plan on the same

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<sup>29/</sup> Compare NECA/NTCA/OPASTCO/et al. at 3, 8; CenturyTel at 10-11; GVNW at 2; MTA at 4; Oklahoma RTCs at 12; OIU/HTC at 3-4; PRTC at 6-7; SDTA at 4-5; Valor at 4-5, *with RTF Order*, 16 FCC Rcd at 11311, ¶ 174.

<sup>30/</sup> See, e.g., NECA/NTCA/OPASTCO/et al. at 3-4, 8.

<sup>31/</sup> CenturyTel at 15-18; accord, Nebraska RICs at 7-8; Wiggins at 3-4.

date, or they should share the same transition path.” <sup>32/</sup> Western Wireless concurs with GCI’s proposed clarification, which would preserve full portability and competitive neutrality.

## CONCLUSION

For the reasons stated above, in the attached report, and in the Petition, the Commission should expeditiously open a rulemaking proceeding to eliminate rate-of-return regulation and replace it with a forward-looking, competitively neutral system. Western Wireless would also support the Commission’s referring this matter to the Federal-State Joint Board on Universal Service for a recommendation on replacing the ROR-based universal service support mechanisms with a competitively-neutral, forward-looking, least cost technology-based universal service funding mechanism for all carriers.

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<sup>32/</sup> GCI at 17.



Respectfully submitted,

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## **Exhibit A**